BROWN & BROWN INC
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

Or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-13619

BROWN & BROWN, INC.

(Exact name of Registrant as specified in its charter)

Florida	**59-0864469**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
220 South Ridgewood Avenue, Daytona Beach, FL	**32114**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (386) 252-9601

Registrant s Website: www.bbinsurance.com

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the Registrant s common stock, $.10 par value, outstanding as of October 31, 2012, was 143,817,824.

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Disclosure Regarding Forward-Looking Statements

Brown & Brown, Inc., together with its subsidiaries (collectively, we, Brown & Brown or the Company), make forward-looking statements within the safe harbor provision of the Private Securities Litigation Reform Act of 1995, as amended, throughout this report and in the documents we incorporate by reference into this report. You can identify these statements by forward-looking words such as may, will, should, expect, anticipate, believe, intend, estimate, plan and continue or similar words. We have based these statements on our current expect about future events. Although we believe the expectations expressed in the forward-looking statements included in this Form 10-Q and the reports, statements, information and announcements incorporated by reference into this report are based on reasonable assumptions within the bounds of our knowledge of our business, a number of factors could cause actual results to differ materially from those expressed in any forward-looking statements, whether oral or written, made by us or on our behalf. Many of these factors have previously been identified in filings or statements made by us or on our behalf. Important factors which could cause our actual results to differ materially from the forward-looking statements in this report include the following items, in addition to those matters described in Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations :

Projections of revenues, income, losses, cash flows, capital expenditures;

Future prospects;

Plans for future operations;

Expectations of the economic environment;

Material adverse changes in economic conditions in the markets we serve and in the general economy;

Future regulatory actions and conditions in the states in which we conduct our business;

Competition from others in the insurance agency, wholesale brokerage, insurance programs and service business;

The occurrence of adverse economic conditions, an adverse regulatory climate, or a disaster in California, Florida, Georgia, Indiana, Louisiana, Massachusetts, Michigan, New Jersey, New York, Pennsylvania, Texas and Washington, because a significant portion of business written by Brown & Brown is for customers located in these states;

The integration of our operations with those of businesses or assets we have acquired, including our January 2012 acquisition of Arrowhead General Insurance Agency Superholding Corporation (Arrowhead), or may acquire in the future and the failure to realize the expected benefits of such acquisition and integration;

Premium rates and exposure units set by insurance companies which have traditionally varied and are difficult to predict;

Our ability to forecast liquidity needs through at least the end of 2012;

- Our ability to renew or replace expiring leases;
- Outcome of legal proceedings and governmental investigations;
- Policy cancellations which can be unpredictable;
- Potential changes to the tax rate that would affect the value of deferred tax assets and liabilities;
- The inherent uncertainty in making estimates, judgments, and assumptions in the preparation of financial statements in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP);
- The performance of acquired businesses and its effect on estimated acquisition earn-out payable;
- Other risks and uncertainties as may be detailed from time to time in our public announcements and Securities and Exchange Commission (SEC) filings; and
- Assumptions as to any of the foregoing and all statements that are not based on historical fact but rather reflect our current expectations concerning future results and events.

Forward-looking statements that we make or that are made by others on our behalf are based on a knowledge of our business and the environment in which we operate, but because of the factors listed above, among others, actual results may differ from those in the forward-looking statements. Consequently, these cautionary statements qualify all of the forward-looking statements we make herein. We cannot assure you that the results or developments anticipated by us will be realized or, even if substantially realized, that those results or developments will result in the expected consequences for us or affect us, our business or our operations in the way we expect. We caution readers not to place undue reliance on these forward-looking statements, which speak only as of their dates. We assume no obligation to update any of the forward-looking statements.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS (UNAUDITED)

BROWN & BROWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(in thousands, except per share data)	For the three months ended September 30, 2012	For the three months ended September 30, 2011	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011
REVENUES				
Commissions and fees	$ 302,310	$ 257,177	$ 888,785	$ 764,612
Investment income	239	317	561	934
Other income, net	1,251	2,907	7,856	3,899
Total revenues	303,800	260,401	897,202	769,445
EXPENSES				
Employee compensation and benefits	149,691	126,877	450,039	379,286
Non-cash stock-based compensation	3,908	2,856	11,393	8,338
Other operating expenses	43,774	38,434	129,394	109,489
Amortization	15,956	13,725	47,450	40,790
Depreciation	3,958	3,062	11,383	9,276
Interest	4,006	3,565	12,093	10,780
Change in estimated acquisition earn-out payables	858	(810)	(134)	656
Total expenses	222,151	187,709	661,618	558,615
Income before income taxes	81,649	72,692	235,584	210,830
Income taxes	32,145	28,519	94,176	83,329
Net income	$ 49,504	$ 44,173	$ 141,408	$ 127,501
Net income per share:				
Basic	$ 0.34	$ 0.31	$ 0.99	$ 0.89
Diluted	$ 0.34	$ 0.30	$ 0.97	$ 0.88
Weighted average number of shares outstanding:				
Basic	139,465	138,690	139,185	138,475
Diluted	142,097	140,443	141,769	140,120
Dividends declared per share	$ 0.0850	$ 0.0800	$ 0.2550	$ 0.2400

See accompanying notes to condensed consolidated financial statements.

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BROWN & BROWN, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except per share data)	September 30, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 244,637	$ 286,305
Restricted cash and investments	198,137	130,535
Short-term investments	8,176	7,627
Premiums, commissions and fees receivable	282,972	240,257
Deferred income taxes	18,792	19,863
Other current assets	32,794	23,540
Total current assets	785,508	708,127
Fixed assets, net	73,191	61,360
Goodwill	1,686,460	1,323,469
Amortizable intangible assets, net	567,489	496,182
Other assets	22,081	17,873
Total assets	$ 3,134,729	$ 2,607,011
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Premiums payable to insurance companies	$ 397,995	$ 327,096
Premium deposits and credits due customers	47,798	30,048
Accounts payable	57,046	22,384
Accrued expenses and other liabilities	120,667	100,865
Current portion of long-term debt	93	1,227
Total current liabilities	623,599	481,620
Long-term debt	450,000	250,033
Deferred income taxes, net	229,458	178,052
Other liabilities	62,858	53,343
Shareholders Equity:		
Common stock, par value $0.10 per share; authorized 280,000 shares; issued and outstanding 143,817 at 2012 and 143,352 at 2011	14,382	14,335
Additional paid-in capital	327,053	307,059
Retained earnings	1,427,379	1,322,562
Accumulated other comprehensive income, net of related income tax effect of $0 at 2012 and $4 at 2011		7
Total shareholders equity	1,768,814	1,643,963
Total liabilities and shareholders equity	$ 3,134,729	$ 2,607,011

See accompanying notes to condensed consolidated financial statements.

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BROWN & BROWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	For the nine months ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$ 141,408	$ 127,501
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	47,450	40,790
Depreciation	11,383	9,276
Non-cash stock-based compensation	11,393	8,338
Change in estimated acquisition earn-out payables	(134)	656
Deferred income taxes	30,233	30,927
Income tax benefit from exercise of shares from the stock benefit plans	(279)	(228)
Net (gain) on sales of investments, fixed assets and customer accounts	(2,692)	(639)
Payments on acquisition earn-outs in excess of original estimated payables	(1,693)	
Changes in operating assets and liabilities, net of effect from acquisitions and divestitures:		
Restricted cash and investments (increase)	(67,602)	(22,439)
Premiums, commissions and fees receivable decrease	8,798	5,427
Other assets decrease (increase)	3,400	(9,150)
Premiums payable to insurance companies (decrease) increase	(12,999)	8,325
Premium deposits and credits due customers increase	17,698	17,669
Accounts payable increase (decrease)	23,677	(5,157)
Accrued expenses and other liabilities (decrease)	(1,982)	(4,974)
Other liabilities (decrease)	(19,083)	(5,099)
Net cash provided by operating activities	188,976	201,223
Cash flows from investing activities:		
Additions to fixed assets	(18,915)	(9,507)
Payments for businesses acquired, net of cash acquired	(384,596)	(99,060)
Proceeds from sales of fixed assets and customer accounts	5,239	1,330
Purchases of investments	(6,152)	(7,908)
Proceeds from sales of investments	5,645	8,161
Net cash used in investing activities	(398,779)	(106,984)
Cash flows from financing activities:		
Payments on acquisition earn-outs	(2,695)	(5,267)
Proceeds from long-term debt	200,000	100,000
Payments on long-term debt	(1,227)	(101,843)
Borrowings on revolving credit facilities	100,000	
Payments on revolving credit facilities	(100,000)	
Income tax benefit from exercise of shares from the stock benefit plans	279	228
Issuances of common stock for employee stock benefit plans	9,590	8,633
Repurchase of stock benefit plan shares for employees to fund tax withholdings	(1,221)	(171)
Cash dividends paid	(36,591)	(34,306)
Net cash provided by (used in) financing activities	168,135	(32,726)
Net (decrease) increase in cash and cash equivalents	(41,668)	61,513

Cash and cash equivalents at beginning of period	286,305	272,984
Cash and cash equivalents at end of period	$ 244,637	$ 334,497

See accompanying notes to condensed consolidated financial statements.

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BROWN & BROWN, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1· Nature of Operations

Brown & Brown, Inc., a Florida corporation, and its subsidiaries (collectively, Brown & Brown or the Company) is a diversified insurance agency, wholesale brokerage, insurance programs and services organization that markets and sells to its customers insurance products and services, primarily in the property and casualty area. Brown & Brown s business is divided into four reportable segments: the Retail Division, which provides a broad range of insurance products and services to commercial, public entity, professional and individual customers; the National Programs Division, which is composed of two units Professional Programs, which provides professional liability and related package products for certain professionals delivered through nationwide networks of independent agents, and Special Programs, which markets targeted products and services designated for specific industries, trade groups, governmental entities and market niches; the Wholesale Brokerage Division, which markets and sells excess and surplus commercial insurance and reinsurance, primarily through independent agents and brokers; and the Services Division, which provides insurance-related services, including third-party claims administration and comprehensive medical utilization management services in both the workers compensation and all-lines liability arenas, as well as Medicare set-aside services and Social Security disability and Medicare benefits advocacy services.

NOTE 2· Basis of Financial Reporting

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto set forth in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Effective January 1, 2012, certain profit center offices were reclassified from the National Programs Division to the Wholesale Brokerage Division, and as such, certain prior year amounts have been reclassified to conform to the current year presentation.

Results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

NOTE 3· Net Income Per Share

Accounting Standards Codification (ASC) Topic 260 Earnings Per Share is the authoritative guidance that states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines EPS for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. Performance stock shares granted to employees under the Company s Performance Stock Plan and Stock Incentive Plan are considered participating securities as they receive non-forfeitable dividend equivalents at the same rate as common stock.

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Basic EPS is computed based on the weighted average number of common shares (including participating securities) issued and outstanding during the period. Diluted EPS is computed based on the weighted average number of common shares issued and outstanding plus equivalent shares assuming the exercise of stock options. The dilutive effect of stock options is computed by application of the treasury stock method. The following is a reconciliation between basic and diluted weighted average shares outstanding:

(in thousands, except per share data)	For the three months ended September 30, 2012	For the three months ended September 30, 2011	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011
Net income	$ 49,504	$ 44,173	$ 141,408	$ 127,501
Net income attributable to unvested awarded performance stock	(1,428)	(1,395)	(4,174)	(3,959)
Net income attributable to common shares	$ 48,076	$ 42,778	$ 137,234	$ 123,542
Weighted average number of common shares outstanding basic	143,607	143,212	143,418	142,913
Less unvested awarded performance stock included in weighted average number of common shares outstanding basic	(4,142)	(4,522)	(4,233)	(4,438)
Weighted average number of common shares outstanding for basic earnings per common share	139,465	138,690	139,185	138,475
Dilutive effect of stock options	2,632	1,753	2,584	1,645
Weighted average number of shares outstanding diluted	142,097	140,443	141,769	140,120
Net income per share:				
Basic	$ 0.34	$ 0.31	$ 0.99	$ 0.89
Diluted	$ 0.34	$ 0.30	$ 0.97	$ 0.88

NOTE 4· New Accounting Pronouncements

Goodwill Impairment In September 2011, the FASB issued authoritative guidance which simplifies goodwill impairment testing by allowing an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. An entity is no longer required to determine the fair value of a reporting unit unless it is more likely than not that the fair value is less than carrying value. The guidance is effective for interim and annual periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this guidance did not have any material impact on the Company s Condensed Consolidated Financial Statements.

NOTE 5· Business Combinations

Acquisitions in 2012

During 2012, Brown & Brown has acquired the assets and assumed certain liabilities of 11 insurance intermediaries, all of the stock of one insurance intermediary and a book of business (customer accounts). The aggregate purchase price of these acquisitions was $620,144,000, including $443,475,000 of cash payments, the issuance of notes payable of $59,000, the issuance of $25,776,000 in other payables, the assumption of $135,779,000 of liabilities and $15,055,000 of recorded earn-out payables. The other payables amount includes $22,594,000 that the Company is obligated to pay all shareholders of Arrowhead General Insurance Agency Superholding Corporation (Arrowhead) on a pro rata basis for certain pre-merger corporate tax refunds and estimated certain potential future income tax credits that were created by net operating loss carryforwards originating from transaction-related tax benefit items. All of these acquisitions were acquired primarily to expand Brown & Brown s core businesses and to attract and hire high-quality individuals. Acquisition purchase prices are typically based on a multiple of average annual operating profit earned over a one- to three-year period within a minimum and maximum price range. The recorded purchase price for all acquisitions consummated after January 1, 2009 included an estimation of the fair value of liabilities associated with any potential earn-out provisions. Subsequent changes in the fair value of earn-out obligations will be recorded in the consolidated statement of income when incurred.

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The fair value of earn-out obligations is based on the present value of the expected future payments to be made to the sellers of the acquired businesses in accordance with the provisions outlined in the respective purchase agreements. In determining fair value, the acquired business s future performance is estimated using financial projections developed by management for the acquired business and reflects market participant assumptions regarding revenue growth and/or profitability. The expected future payments are estimated on the basis of the earn-out formula and performance targets specified in each purchase agreement compared to the associated financial projections. These payments are then discounted to present value using a risk-adjusted rate that takes into consideration the likelihood that the forecasted earn-out payments will be made.

Based on the acquisition date and the complexity of the underlying valuation work, certain amounts included in the Company s Condensed Consolidated Financial Statements may be provisional and thus subject to further adjustments within the permitted measurement period, as defined in ASC Topic 805 Business Combinations. However, the Company does not expect any adjustments to such allocations to be material to the Company s Condensed Consolidated Financial Statements. These acquisitions have been accounted for as business combinations and are as follows:

(in thousands)

Name	**Business Segment**	**2012 Date of Acquisition**	**Cash Paid**	**Note Payable**	**Other Payable**	**Recorded Earn-out Payable**	**Net Assets Acquired**	***Maximum Potential Earn-out Payable***
Arrowhead General Insurance Agency Superholding Corporation	National Programs; Services	January 9	$ 397,531	$	$ 22,694	$ 3,634	$ 423,859	*$ 5,000*
Insurcorp & GGM Investments LLC (d/b/a Maalouf Benefit Resources)	Retail	May 1	15,500		900	4,944	21,344	*17,000*
Texas Security General Insurance Agency, Inc.	Wholesale	September 1	14,506		2,182	2,124	18,812	*7,200*
Other	Various	Various	15,938	59		4,353	20,350	*10,235*
Total			$ 443,475	$ 59	$ 25,776	$ 15,055	$ 484,365	*$ 39,435*

The following table summarizes the estimated fair values of the aggregate assets and liabilities acquired as of the date of each acquisition:

(in thousands)	**Arrowhead**	**Insurcorp**	**Texas Security**	**Other**	**Total**
Cash	$ 61,786	$	$	$	$ 61,786
Other current assets	69,051	180	1,882	524	71,637
Fixed assets	4,629	25	45	67	4,766
Goodwill	322,779	14,745	10,776	12,818	361,118
Purchased customer accounts	99,515	6,490	6,227	8,371	120,603
Non-compete agreements	100	22	14	97	233
Other assets	1				1
Total assets acquired	557,861	21,462	18,944	21,877	620,144
Other current liabilities	(107,579)	(118)	(132)	(1,527)	(109,356)
Deferred income taxes, net	(26,423)				(26,423)
Total liabilities assumed	(134,002)	(118)	(132)	(1,527)	(135,779)
Net assets acquired	$ 423,859	$ 21,344	$ 18,812	$ 20,350	$ 484,365

The weighted average useful lives for the acquired amortizable intangible assets are as follows: purchased customer accounts, 15.0 years; and non-compete agreements, 5.0 years.

Goodwill of $361,118,000, was allocated to the Retail, National Programs, Wholesale Brokerage and Services Divisions in the amounts of $26,753,000, $253,766,000, $11,586,000 and $69,013,000, respectively. Of the total goodwill of $361,118,000, $28,326,000 is currently deductible for income tax purposes and $317,737,000 is non-deductible. The remaining $15,055,000 relates to the recorded earn-out payables and will not be deductible until it is earned and paid.

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The results of operations for the acquisitions completed during 2012 have been combined with those of the Company since their respective acquisition dates. The total revenues and income before income taxes from the acquisitions completed through September 30, 2012, included in the Condensed Consolidated Statement of Income for the three months ended September 30, 2012, were $37,754,000 and $4,731,000, respectively. The total revenues and income before income taxes from the acquisitions completed through September 30, 2012, included in the Condensed Consolidated Statement of Income for the nine months ended September 30, 2012, were $96,020,000 and $4,279,000, respectively. If the acquisitions had occurred as of the beginning of the period, the Company s results of operations would be as shown in the following table. These unaudited pro forma results are not necessarily indicative of the actual results of operations that would have occurred had the acquisitions actually been made at the beginning of the respective periods.

(UNAUDITED) (in thousands, except per share data)	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
Total revenues	$ 304,776	$ 292,599	$ 907,796	$ 866,115
Income before income taxes	81,998	81,785	239,286	238,144
Net income	49,715	49,699	143,630	